

occupants of apartments 3 and 4. In determining his net earnings from self-employment, A includes the \$3,600 received from apartments 3 and 4, and the expenses of \$1,100 (\$500 plus one-half of \$1,200) attributable thereto. The rentals and expenses attributable to apartments 1 and 2 are excluded. Therefore, A has \$2,500 of net earnings from self-employment for the taxable year from the building.

(d) *Treatment of business income which includes rentals from real estate.* Except in the case of a real-estate dealer, where an individual or a partnership is engaged in a trade or business the income of which is classifiable in part as rentals from real estate, only that portion of such income which is not classifiable as rentals from real estate, and the expenses attributable to such portion, are included in determining net earnings from self-employment.

[T.D. 6691, 28 FR 12796, Dec. 3, 1963, as amended by T.D. 7710, 45 FR 50739, July 31, 1980]

§ 1.1402(a)-5 Dividends and interest.

(a) All dividends on shares of stock are excluded unless they are received by an individual in the course of his trade or business as a dealer in stocks or securities.

(b) Interest on any bond, debenture, note, or certificate, or other evidence of indebtedness, issued with interest coupons or in registered form by any corporation (including one issued by a government or political subdivision thereof) is excluded unless such interest is received in the course of a trade or business as a dealer in stocks or securities. However, interest with respect to which a credit against tax is allowable as provided in section 35, that is, interest on certain obligations of the United States and its instrumentalities, is not included in net earnings from self-employment even though received in the course of a trade or business as a dealer in stocks or securities. Only interest on bonds, debentures, notes, or certificates, or other evidence of indebtedness, issued with interest coupons or in registered form by a corporation, is excluded in the case of all persons other than dealers in stocks or securities; other interest received in the course of any trade or business (such as interest received by a pawnbroker on his loans or interest received

by a merchant on his accounts or notes receivable) is not excluded.

(c) Dividends and interest of the character excludable under paragraphs (a) and (b) of this section received by an individual on stocks or securities held for speculation or investment are excluded whether or not the individual is a dealer in stocks or securities.

(d) A dealer in stocks or securities is a merchant of stocks or securities with an established place of business, regularly engaged in the business of purchasing stocks or securities and reselling them to customers; that is, he is one who as a merchant buys stocks or securities and sells them to customers with a view to the gains and profits that may be derived therefrom. Persons who buy and sell or hold stocks or securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, are not dealers in stocks or securities.

§ 1.1402(a)-6 Gain or loss from disposition of property.

(a) There is excluded any gain or loss: (1) Which is considered as gain or loss from the sale or exchange of a capital asset; (2) from the cutting of timber or the disposal of timber, coal, or iron ore, even though held primarily for sale to customers, if section 631 is applicable to such gain or loss; and (3) from the sale, exchange, involuntary conversion, or other disposition of property if such property is neither (i) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, nor (ii) property held primarily for sale to customers in the ordinary course of a trade or business. For the purpose of the special rule in subparagraph (3) of this paragraph, it is immaterial whether a gain or loss is treated as a capital gain or loss or as an ordinary gain or loss for purposes other than determining net earnings from self-employment. For instance, where the character of a loss is governed by the provisions of section 1231, such loss is excluded in determining net earnings from self-employment even though such loss is treated under section 1231 as an ordinary loss. For the purposes of this special rule,

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the term “involuntary conversion” means a compulsory or involuntary conversion of property into other property or money as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof; and the term “other disposition” includes the destruction or loss, in whole or in part, of property by fire, storm, shipwreck, or other casualty, or by theft, even though there is no conversion of such property into other property or money.

(b) The application of this section may be illustrated by the following example:

Example. During the taxable year 1954, A, who owns a grocery store, realized a net profit of \$1,500 from the sale of groceries and a gain of \$350 from the sale of a refrigerator case. During the same year, he sustained a loss of \$2,000 as a result of damage by fire to the store building. In computing taxable income, all of these items are taken into account. In determining net earnings from self-employment, however, only the \$1,500 of profit derived from the sale of groceries is included. The \$350 gain and the \$2,000 loss are excluded.

[T.D. 6691, 28 FR 12796, Dec. 3, 1963, as amended by T.D. 6841, 30 FR 9309, July 27, 1965]

§ 1.1402(a)-7 Net operating loss deduction.

The deduction provided by section 172, relating to net operating losses sustained in years other than the taxable year, is excluded.

§ 1.1402(a)-8 Community income.

(a) *In case of an individual.* If any of the income derived by an individual from a trade or business (other than a trade or business carried on by a partnership) is community income under community property laws applicable to such income, all of the gross income, and the deductions attributable to such income, shall be treated as the gross income and deductions of the husband unless the wife exercises substantially all of the management and control of such trade or business, in which case all of such gross income and deductions shall be treated as the gross income and deductions of the wife. For the purpose of this special rule, the term “management and control” means management and control in fact, not

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the management and control imputed to the husband under the community property laws. For example, a wife who operates a beauty parlor without any appreciable collaboration on the part of her husband will be considered as having substantially all of the management and control of such business despite the provision of any community property law vesting in the husband the right of management and control of community property; and the income and deductions attributable to the operation of such beauty parlor will be considered the income and deductions of the wife.

(b) *In case of a partnership.* Even though a portion of a partner’s distributive share of the income or loss, described in section 702(a)(9), from a trade or business carried on by a partnership is community income or loss under the community property laws applicable to such share, all of such distributive share shall be included in computing the net earnings from self-employment of such partner; no part of such share shall be taken into account in computing the net earnings from self-employment of the spouse of such partner. In any case in which both spouses are members of the same partnership, the distributive share of the income or loss of each spouse is included in computing the net earnings from self-employment of that spouse.

§ 1.1402(a)-9 Puerto Rico.

(a) *Residents.* A resident of Puerto Rico, whether or not a bona fide resident thereof during the entire taxable year, and whether or not an alien, a citizen of the United States, or a citizen of Puerto Rico, shall compute his net earnings from self-employment in the same manner as would a citizen of the United States residing in the United States. See paragraph (d) of § 1.1402(b)-1 for regulations relating to nonresident aliens. For the purpose of the tax on self-employment income, the gross income of such a resident of Puerto Rico also includes income from Puerto Rican sources. Thus, under this special rule, income from Puerto Rican sources will be included in determining net earnings from self-employment of a resident of Puerto Rico engaged in the active conduct of a trade or business in